Q. What is the experience of other countries with national retail sales taxes?

A. No country has attempted a truly ambitious retail sales tax. Those that have tried more modest versions have abandoned them in favor of value-added taxes.

Many countries have attempted to implement national retail sales taxes or variants, such as wholesale-level taxes or “ring” taxes (retail sales taxes with exemptions for businesses “in the ring”). But not for long. In 1967, 19 Organisation for Economic Co-operation and Development countries had some form of wholesale, retail, or “turnover” tax (a tax paid when a good is manufactured, rather than when it is sold). By 1995, all had converted to value-added taxes (VATs) that collect revenue at each stage of production. Developing countries have also largely abandoned retail sales taxes in favor of VATs.

Retail sales tax rates are generally lower than VAT rates, running 4–6 percent as opposed to 14–25 percent. These sales tax rates are also much lower than the rate advocated by proponents of the national retail sales tax. Only a few countries (Iceland, Norway, South Africa, Sweden, and Zimbabwe) have ever instituted retail sales taxes with rates in excess of 10 percent. And none of these countries currently maintains such a tax, presumably because high-rate sales taxes invite evasion.

Retail sales taxes got replaced with VATs for good reasons—namely, evasion and “cascading.” Cascading occurs when taxed inputs are used to produce taxed outputs, so that the total tax on goods compounds beyond what was intended. This effect can be avoided by exempting all business purchases from taxation. But separating business purchases from consumer purchases is difficult. Moving to a VAT solves the problem because businesses receive credits for the taxes paid on their input purchases.

Evasion is higher under a retail sales tax than under a VAT for several reasons. First, the retail level is the weakest link in the enforcement chain. Second, if a retailer evades a sales tax, the full tax on the sale is lost. But with a VAT, successful evasion by retailers only costs the government the tax on the retailer's value added. Third, sales taxes do not produce a paper trail enforcers can easily follow.
How Could We Improve the Federal Tax System?

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Further Reading


